



PENN WHARTON  
UNIVERSITY *of* PENNSYLVANIA

# Budget Model

## Small Business Identification

How and Why

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# Overview

- How
  - Tax Data
  - Simple & Malleable Rules
- Why
  - Policy Goal
  - Inconsistent

# Small Business Definition

- The Tax Code provides no single, explicit definition of small business.
- Definitions used for spending programs appear to be overly broad and problematic to apply to tax data.
- Definition of small business can be improved from labeling all pass through businesses as small businesses.

# Overview of Methodology

- Keep tests and thresholds simple and constant across all business returns.
- Count all income and deductions that are reported by business entity, including Schedule K.
- Exclude entities that only report income, but allow entities that only report deductions.

# Small Business Methodology

- Step 1: Consider all “business” income base.
  - Include sole proprietors, partnerships, S and C corporations, Schedule E rental real estate, farmers
  - Include any investment income and deductions from Schedule K for partnerships and S corporations
- Step 2: Separate business from non-business activity.
- Step 3: Separate small businesses from all businesses.

# What is a Business?

We use three general principles to distinguish business from non-business activity:

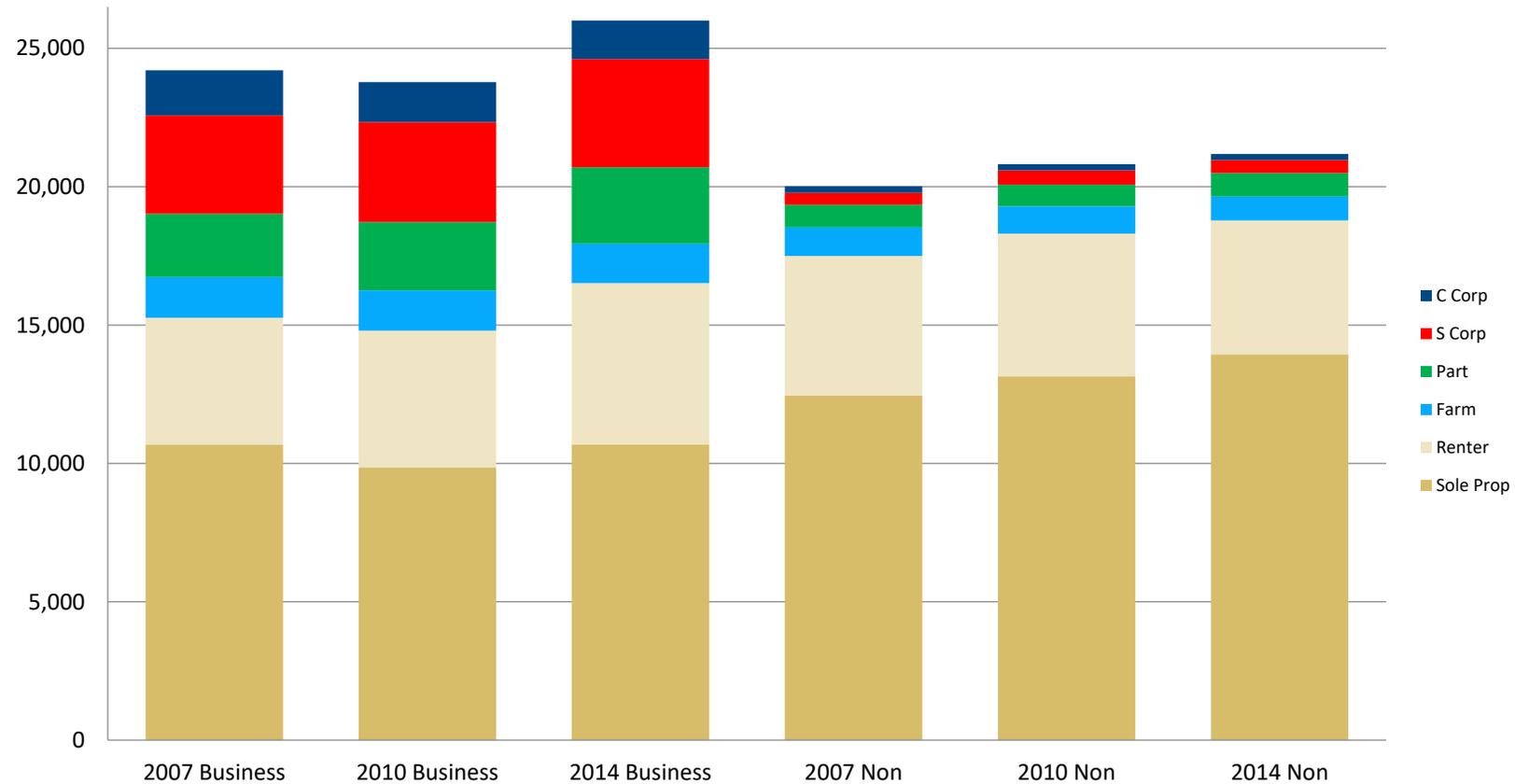
1. Does the entity attempt to make a profit?
2. Do the owners operate in a “businesslike” manner?
3. Does the activity have *potential* to generate non-negligible income for the owners?

# Business Test

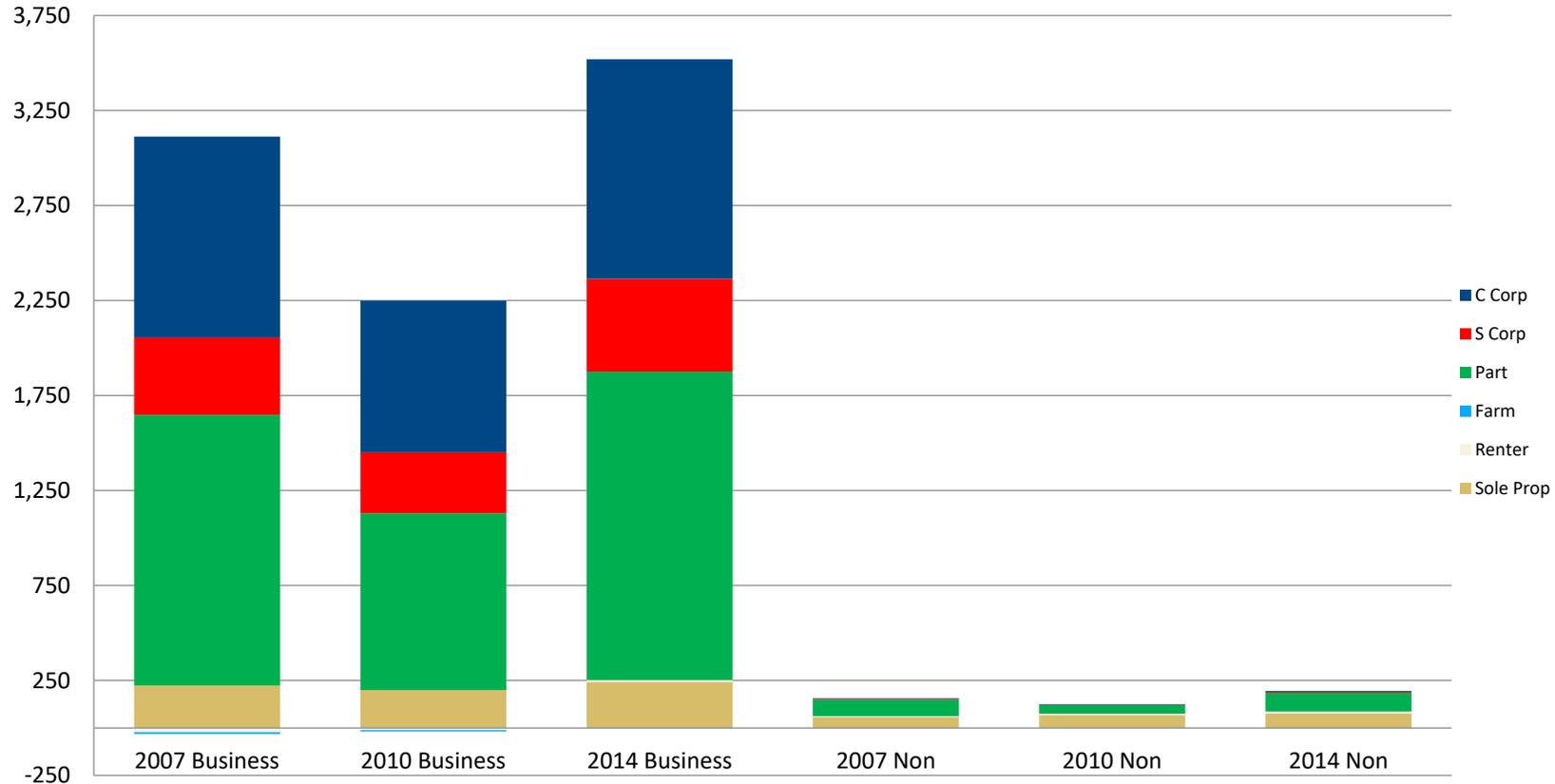
- Test 1: De Minimis Activity
  - Total Deductions or Total Income  $\geq$  \$10,000
  - OR
  - Total Deductions and Total Income  $\geq$  \$15,000
- Test 2: General Business Activity
  - Total Deductions  $>$  \$5,000

# Identifying Businesses

## Thousands of Filers



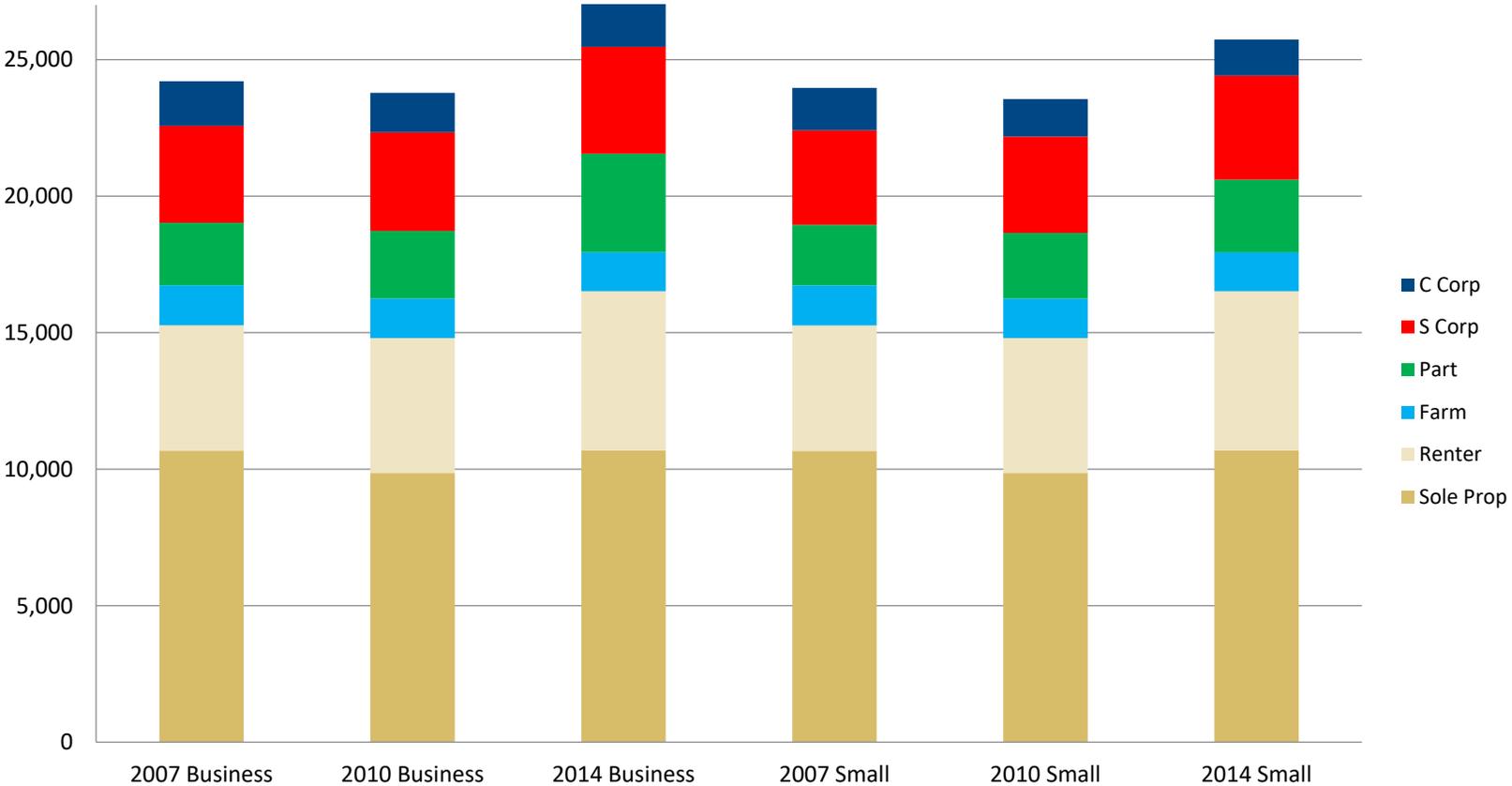
# Business vs. Non-Business Net Income, Billions of Dollars



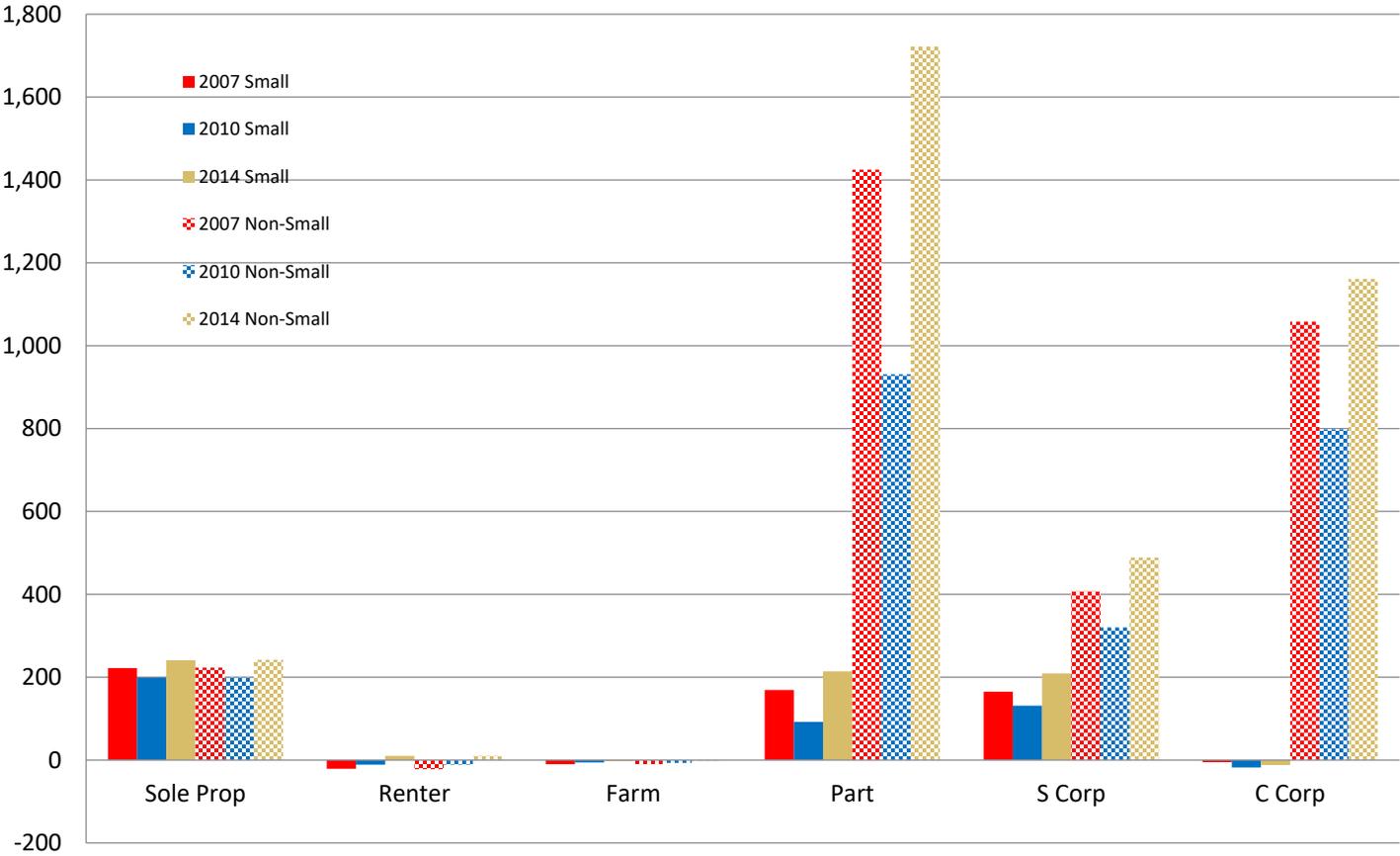
# Identification of Small Businesses

- We define small business as entity that reports < \$10 million Total Income and < \$10 million in Total Deductions.
- Result:
  - For each year, we retained 99% of business entities, but between only 17% and 18% of total income and between 17% and 19% of net income.

# Business vs. Small Business Thousands of Filers



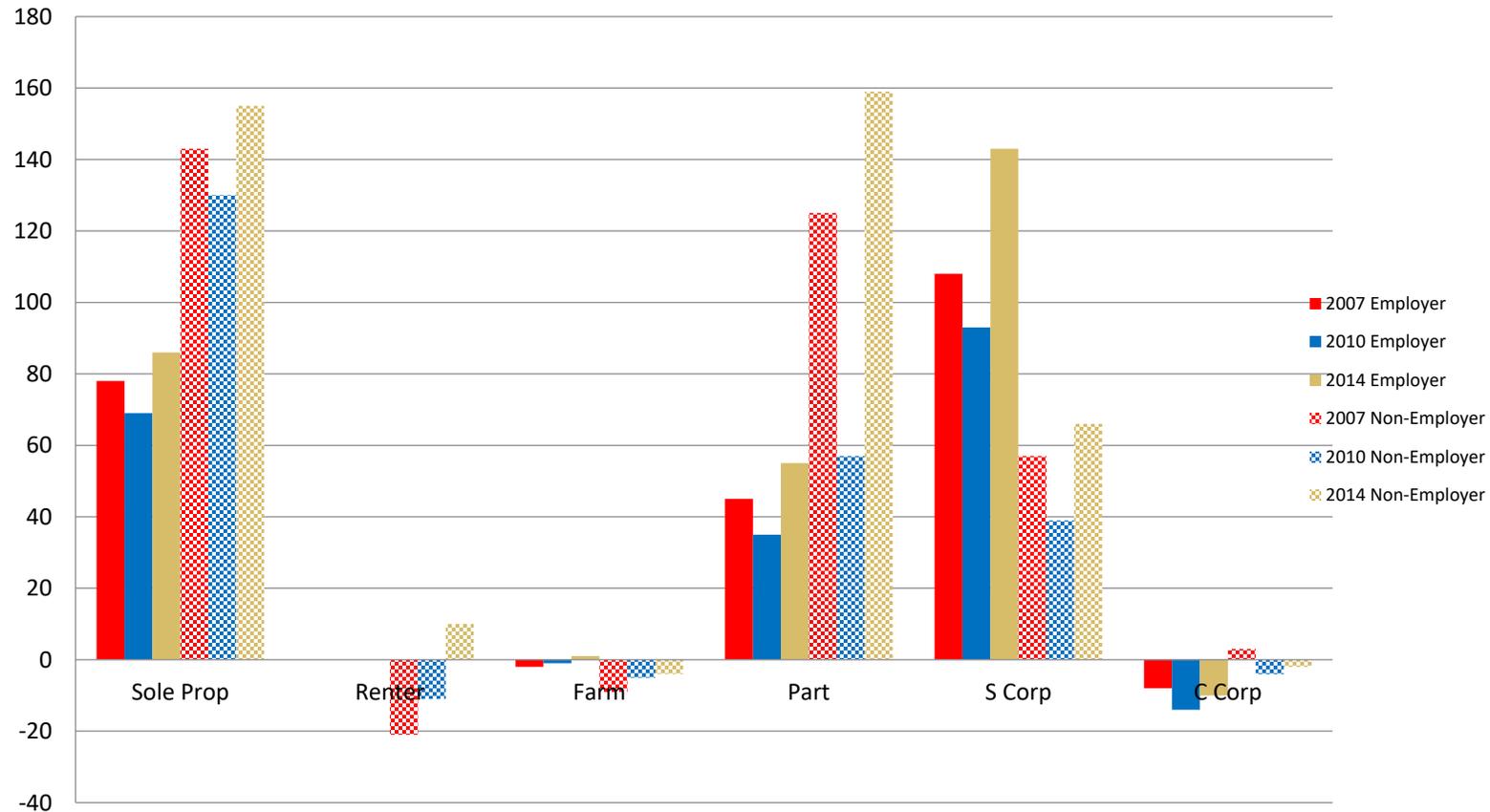
# Business vs. Small Business Net Income, Billions of Dollars



# Identification of Employers

- We define a small business as an employer if entity reports  $>$  \$10K in labor deductions
- Result:
  - For each year, only 20% of small businesses are employers.

# Small Business Employers Net Income, Billions of Dollars



# CARES ACT (PPP)

- Loan program 'Small Business'
- Eligibility
  - # employees at establishment (phase 1 &2)
  - Size of lender (phase 2)

# CARES ACT (PPP)

Table 1. Characteristics by Firm Size, 2016

	Number of Firms	Employment	Annual payroll (\$1,000)
Number of Employees			
500 or more	0.3%	52.7%	59.3%
Fewer than 500	99.7%	47.3%	40.7%
100-499	1.5%	14.0%	13.5%
20-99	9.0%	16.6%	14.0%
5-19	27.6%	11.9%	9.0%
0-4	61.6%	4.7%	4.2%
Total	5,954,684	126,752,238	6,435,142,055

Source: U.S. Census Bureau, Statistics of U.S. Businesses 2016

# CARES ACT (PPP)

Table 2. Average Annual Growth in Wages and Employment by Size Category, 2012-2016

Firm Size (Number of Employees)	Wages		Employment	
	Percent Change	Contribution to Percent Change	Percent Change	Contribution to Percent Change
	Total	4.3	4.3	2.1
500 or more	4.8	2.7	2.6	1.3
100-499	4.5	0.6	2.2	0.3
50-99	3.4	0.2	1.8	0.1
20-49	3.6	0.3	2.3	0.2
0-19	3	0.4	0.7	0.1



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